In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-625

CAREY J. PERRY, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The question presented in this income tax case is whether the court of appeals correctly held that purported rental payments, made by petitioners pursuant to a gift and leaseback arrangement, were not deductible as ordinary and necessary business expenses under Section 162(a)(3) of the Internal Revenue Code of 1954.

The pertinent facts are as follows: Petitioners[1] are physicians. In December, 1968, they transferred their interests in the office building in which they conducted their medical practices to short-term trusts for the benefit of their children. The trust created by Dr. Perry was to last ten years, and the trust created by Dr. Medders was to last fourteen years; the trustee under both trusts was a local bank (Pet. App. 2a, 13a). The corpus of each of the trusts was to revert to the petitioner-settlors at the end of the trust term (Pet. App. 13a-14a).

Prior to the actual transfer of the property to the trusts, a leaseback arrangement was agreed upon with the prospective trustee pursuant to which each petitioner leased back his respective interest in the office building for the entire term of the trust he had creased, at a concededly fair rental (Pet. App. 2a, 5a, 14a). Petitioners were the sole occupants of the office building and continued to use it without interruption (Pet. App. 2a). Although the trustee was nominally given broad management powers, it in fact held only legal title to the building (Pet. App. 16a).

The district court upheld petitioners' claimed business expense deduction for the rent under Section 162(a)(3) of the Code (Pet. App. 1a-9a). The court of appeals reversed. It held that the gift and leaseback transaction as a whole had no real business

[1] "Petitioners" refers to Carey J. Perry and J. Doyle Medders. Marietta M. Perry and Constance D. Medders are parties solely because they filed joint returns with their husbands for the taxable year at issue.

purpose, so that the claimed rental deduction was not allowable (Pet. App. 12a-19a).

In holding that petitioners' payments to their trusts, which existed primarily as a vehicle for diverting income to their children, could not form the basis of a business expense deduction, the court of appeals followed the Fifth Circuit's well-reasoned decision in *Van Zandt* v. *Commissioner*, 341 F.2d 440, certiorari denied, 382 U.S. 814, which was recently reaffirmed by that court in *Mathews* v. *Commissioner*, No. 74-2084, decided October 1, 1975. *Skemp* v. *Commissioner*, 168 F.2d 598 (C.A. 7) (Pet. 9) is not to the contrary. As the court of appeals noted (Pet. App. 17a), the result in *Skemp* turned on the fact that more property was conveyed to the trustee than was leased back to the doctor for his use. Under these circumstances, the trustee was not solely a conduit for the diversion of the doctor's earnings to his wife and children. See also *Van Zandt* v. *Commissioner*, *supra*, 341 F.2d at 442. Moreover, in *Skemp*, the grantor retained no reversionary interest in the property upon the termination of the trusts.

Similarly, *Brooke* v. *United States*, 468 F.2d 1155 (C.A. 9) and *Brown* v. *Commissioner*, 180 F.2d 926 (C.A. 3), certiorari denied, 340 U.S. 814, relied upon by petitioner (Pet. 9), do not conflict with the decision below. Unlike this case, *Brooke* involved an absolute, outright conveyance to the taxpayer's children, and not a trust for a term of years. *Brown* involved the transfer by the taxpayer of coal-produc-

ing property and a railroad siding to a trust for the transferors' children for twenty-two years. However, unlike the situation in this case where the terms of the lease and the trust were co-extensive,[2] the taxpayer in *Brown* leased the coal land for five years and the railroad siding for ten years. Under these circumstances, the court in that case treated the trust and leaseback as separate transactions. Finally, unlike this case where the trust corpus was to revert to petitioners upon the termination of the trusts, the taxpayer in *Brown* retained no reversionary interest in the trust property.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

DECEMBER 1975.

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[2] As the court stated in *Van Zandt* v. *Commissioner, supra,* 341 F.2d at 444:

> * * * factors such as the short term of the trust, reversion to the settlors, predetermination of the right to possession of the property, and the like * * * bear heavily on the element of business purpose.

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